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C O N F I D E N T I A L SECTION 01 OF 02 TEGUCIGALPA 002420

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SUBJECT: PART III: WHAT DOES A LIBERAL PARTY VICTORY MEAN
FOR THE HONDURAN ECONOMY AND U.S. ECONOMIC INTERESTS?

REF: TEGUCIGALPA 1993 AND PREVIOUS

Classified By: Economic Chief Patrick Dunn for reasons 1.4 (b) and (d).

[11](#). (C) Summary: This is the third of three cables analyzing the Zelaya economic platform. As of early morning on November 28, exit polling indicates an electoral victory for Liberal Party presidential candidate Manuel "Mel" Zelaya Rosales. While we await a formal announcement from electoral authorities, the following cable assesses Zelaya's macroeconomic platform and likely impacts on U.S. interests. Part one provided an overview of the Zelaya economic platform and impacts on the U.S.; part two provided a more in-depth assessment of the impacts of his proposed microeconomic and sectoral policies.

[12](#). (C) Summary Continued: Zelaya's gentleman's agreement with the IMF and unambiguous calls for fiscal discipline are sine qua nons for future macro stability, and his endorsement of decentralization, anti-corruption, improved efficiency and competitiveness are like music to our ears. Post will watch closely how the new administration seeks to balance foreign exchange inflows, exchange rates, interest rates, and liquidity concerns -- perhaps the pre-eminent macroeconomic concern facing the new administration. Finally, Post is encouraged to see Zelaya's platform adopt the Monterrey Consensus position that ultimately Honduras is responsible for implementing the reforms necessary to take full advantage of globalization and lay the foundations for sustainable economic growth. End Summary.

Macroeconomics

[13](#). (C) Publicly and privately, Zelaya has stressed that macroeconomic stability has cost the Honduran public too much to allow poorly considered policies to put it in jeopardy now. He has emphatically said that he intends to continue policies of fiscal discipline, stable exchange rates, low inflation, and combating corruption and tax evasion. Privately, he has also assured both Post and the International Monetary Fund (IMF) that he will continue to uphold the agreed-upon components of the Fund's Poverty Reduction and Growth Facility (PRGF). In a November 28 discussion with EconChief, the IMF resident Representative declined to comment on the significance of an apparent Zelaya victory, saying the Fund is remaining cautious until a clear victor is formally announced by electoral authorities. That said, the Fund remains concerned over how Zelaya would offset the revenue losses from the proposed reduction in fuel taxes and whether his courting of the teachers' unions during the campaign will put at risk completing the teachers' wage reforms that were agreed to with the Fund and that will be key to future fiscal balance. (For more on this, see reftel.)

[14](#). (U) However, Zelaya feels (and clearly the public agrees) that the benefits of these years of austerity have not reached the common man. Zelaya therefore calls for a more progressive tax system and a more adaptable labor system (Note: Here he refers to training, not any relaxation of restrictive labor regulations that inhibit labor market flexibility. End note.) He calls for an opening of decision making regarding economic policy and for improved social equality, but does not explain what that would look like or how it would be achieved.

Exchange Rates

[15](#). (SBU) Zelaya proposes stabilizing the exchange rate and controlling excess liquidity by keeping monetary emissions in line with inflows of foreign exchange reserves. (Comment: With remittances and earnings from non-traditional exports increasing sharply year-on-year, it is not clear to Post how such a policy would be implemented without risking inflation. Further, there seems a conflict between limiting liquidity and providing accessible credit more broadly to spur economic growth. Finally, it is not clear that the exchange rate is

the appropriate target for monetary policy -- the Fund has pushed instead for moving to a freely-floating exchange rate, and using interest-rate targeting to signal macroeconomic intentions to the market. Post will raise this issue with Zelaya's monetary team at the earliest opportunity. End Comment.)

Interest Rates

16. (SBU) Zelaya's plan recognizes that lack of credit and high interest rates (18 percent and higher) have held back economic development. In response, he calls for strengthening banks that provide agricultural credit, creating new savings and loan associations in the rural areas, and strengthening the GOH-supported bank for affordable housing. (Comment: Providing affordable credit requires more than just building more banks. How Zelaya proposes to increase available capital or reduce interest rates (without boosting inflation) is nowhere addressed and remains one of the macroeconomic challenges facing the next administration. End Comment.)

Energy Policy

17. (U) Zelaya proposes to reduce the cost of fuel to consumers by tightening state-imposed profit margins, by combating corruption, and by improving management at the national electrical company ENEE (which currently has technical losses estimated at 27 to 30 percent). He calls for incentives for production of alternative fuels, including ethanol and biodiesel, as well as adoption of wind, solar, hydro, and geothermal generation technologies. He promises a reduction of the GOH tax on fuels, and supports regionalization of the energy market, both to explore volume-discounts for fuel purchases and to build-in economies of scale for electrical generation.

Trade and Investment Policy

18. (U) Zelaya's plan expressly recognizes what is in Post's opinion one of the key disincentives to investment in Honduras: lack of juridical security. Zelaya notes that implementation and enforcement of the new Competition (anti-trust) law and Administrative Simplification law will be cornerstones of this policy. (Comment: This will need to be accompanied by strengthening of the judiciary, but formal recognition of the collusive and anti-competitive nature of the Honduran market is an important first-step. End comment.) On trade, Zelaya is unambiguous, declaring, "we support completing the Central American Customs Union and taking maximum advantage of openings to the American market offered by the entry into force of CAFTA."

19. (U) Perhaps the most important passage in the economic platform is the following, in which Zelaya recognizes Honduras' own responsibility for taking the steps necessary to set the stage for economic growth: "We do not forget that to achieve our goals our country must redouble its efforts in such areas as: investment; modernization of agro-industry; infrastructure improvements; creating a more skilled workforce; rationalizing energy costs; and strengthening the financial services sector. (This must be done) by means of short-, medium-, and long-term plans, because only in this way can we produce more exports, improve our competitiveness, and take better advantage of our resources."

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